**DEPARTMENT OF STATE REVENUE**

**LETTER OF FINDINGS NUMBER: 98-0278**
**Sales and Use Tax**
**For The Period: 1994-1996**

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## ISSUES

### I. Sales/Use Tax: Wheel Loader and Front End Loader

**Authority:** 45 IAC 15-5-3; North Central Industries, Inc. v. Ind. Dept. of State Revenue, 790 N.E.2d 198, 200 (Ind. Tax Ct. 2003); Department of Revenue v. Calcar Quarries, Inc., 394 N.E.2d 939 (Ind. Ct. App., First District 1979); Indiana Dept. of State Revenue v. Cave Stone, Inc., 457 N.E.2d 520 (Ind. 1983); 45 IAC 2.2-5-9; 45 IAC 2.2-5 *et seq.*

The taxpayer protests the imposition of tax on a wheel loader and a front-end loader.

### II. Sales/Use Tax: Rough Terrain Crane

**Authority:** 45 IAC 2.2-5-8(h)(1)

The taxpayer protests the taxation of a rough terrain crane.

### III. Sales/Use Tax: Calcium Chloride

**Authority:** IC 6-2.5-5-30; 45 IAC 2.2-5-70

The taxpayer protests the taxation of calcium chloride.

### IV. Sales/Use Tax: Computer Equipment

**Authority:** 45 IAC 2.2-3-4; IC 6-8.1-5-1(b)

The taxpayer protests the taxation of computer equipment and various other items.

## V. Sales/Use Tax: Public Transportation

**Authority:** IC 6-2.5-5-27; Carnahan Grain, Inc. v. Ind. Dept. of State Revenue, 2005 Ind. Tax LEXIS 29 (Ind. Tax Ct. 2005); Department of Revenue v. Calcar Quarries, Inc., 394 N.E.2d 939 (Ind. Ct. App., First District 1979)

Taxpayer protests that it qualifies for the public transportation exemption.

## VI. Tax Administration: Penalty and Interest

**Authority:** IC 6-8.1-10-2.1; 45 IAC 15-11-2; IC 6-8.1-10-1(e)

Taxpayer protests the imposition of the 10% negligence penalty and interest.

## STATEMENT OF FACTS

The taxpayer's business involves mining, extraction, production, sale and hauling of sand, gravel and stone. The taxpayer characterizes its business as the processing and selling of "sand, stone, gravel and other similar materials (aggregates)…." The taxpayer's facilities "are primarily quarrying operations where aggregates are extracted, crushed, graded and staged for ultimate sale …." More facts will be provided as needed.

## I. Sales/Use Tax: Wheel Loader and Front End Loader

## DISCUSSION

Before examining the taxpayer's protest, it should be noted "[t]he burden of proving that a proposed assessment is incorrect rests with the taxpayer…." 45 IAC 15-5-3. The Indiana Tax Court has also stated: "When a taxpayer claims entitlement to a tax exemption, the taxpayer bears the burden of showing that the terms of the exemption are met." North Central Industries, Inc. v. Ind. Dept. of State Revenue, 790 N.E.2d 198, 200 (Ind. Tax Ct. 2003)(*Citing* Mid-America Energy Resources, Inc. v. Indiana Dept. of State Revenue, 681 N.E.2d 259, 261 (Ind. Tax Ct. 1997)).

Turning to the taxpayer's argument, initially the protest involved three items and the penalty: a wheel loader; a front-end loader; and a rough terrain crane. Although the taxpayer had originally stated that it was protesting the above listed items and was "in agreement with the remainder of the proposed assessment," the taxpayer later expanded the protest. The taxpayer also later disagreed with the "method of sampling" that was used in the audit.

First we will examine the wheel loader and the front-end loader.

**Kawasaki Wheel Loader:**

The taxpayer states: "This loader is used to place aggregate material into the processing plant at our recycle operation. We believe that the 'production process' begins at the loading of material for processing."

**CAT 980G Front End Loader:**

Again, quoting the taxpayer: "This loader is also used to place aggregate material into the processing plant at our recycle operation. We believe that the 'production process' begins at the loading of material for processing."

Among the cases that the taxpayer cites to support its position is Department of Revenue v. Calcar Quarries, Inc., 394 N.E.2d 939 (Ind. Ct. App., First District 1979). Calcar involved a "stone quarry, a hot mix asphalt plant, and a ready mix concrete facility" and various items that Calcar claimed were tax exempt. Id. at 940. The Court of Appeals noted that the trial court found the following:

> That a Caterpillar tractor with *front-end loader*…was used for the purpose of hauling stone in the various stages of production, and that the use of said Caterpillar tractor with *front-end loader* was for the transportation of unfinished work in process in a continuous flow from one production step to another within Calcar's integrated operation. (*Emphasis added*)

Id. at 942. The trial court further found that "the older tractor with front-end loader, for which parts and supplies were purchased" was "used directly to transport unfinished work in process in a continuous flow from one production step to another within Calcar's integrated operations." Id. at 942-3. The Court of Appeals held that "the trial court did not err in finding that the … tractor-loaders were used primarily for the purpose of transporting unfinished work in process from one production step to another." Id. at 943. The Court of Appeals went on to say "the trial court was correct in permitting exemptions for the amounts paid for purchase and repair of these items because they were directly used in direct processing and production." Id. at 943. However, the Court of Appeals in Calcar found that a crane used for "constructing its [Calcar's] asphalt plant" was "[o]bviously, … not a direct use in the direct production of the asphalt" and that a "payloader" that was "used solely for cleaning and maintenance purposes" also was "not a direct use in the direct production or processing of Calcar's products." Id. at 943.

In Indiana Dept. of State Revenue v. Cave Stone, Inc., 457 N.E.2d 520 (Ind. 1983), the Indiana Supreme Court dealt with "facts very similar" to those in Calcar. The Indiana Supreme Court stated, "We believe that the rationale of the First District in *Calcar* is correct." Id. at 525.

The taxpayer has several locations/facilities. Among those are portable recycling plants, where the Kawasaki Wheel Loader and the CAT 980G Front End Loader are used. At hearing taxpayer stated the recycling plants involve the following: when roads are replaced, the government trucks the broken up road (asphalt/concrete) to the taxpayer's recycling plant to process the broken up road. The broken up road is processed to make concrete again.

The main question is *when* does production begin. For example, under 45 IAC 2.2-5-9 equipment like front-end loaders can be exempt depending on how and when the equipment is used. 45 IAC 2.2-5-9(a) states that, "In general, all purchases of tangible personal property by persons engaged in extraction or mining are taxable. The exemption provided in this regulation extends only to manufacturing machinery, tools, and equipment directly used in mining or extraction." The IAC goes on to illustrate the exempt versus taxable distinction: for example, front-end loaders "used to transport coal from a crusher to a wash plant are exempt" and "[f]ront-end loaders … used to load coal onto trucks, railroad cars, or barges for delivery to customers are taxable." 45 IAC 2.2-5-9(g).

From the facts provided by the taxpayer about the recycling operation, it is not entirely clear whether the road is already broken up by the government, or whether the taxpayer does the breaking up of the road. But neither scenario fulfills the "integrated production process" of the Indiana Administrative Code, since there is not what 45 IAC 2.2-5-9(c)(3) calls [by using coal as its example] a "functional interrelationship of the various steps and the flow of the work in process…." This is seen by the fact that if the government breaks up the road there is no functional interrelationship between the government seeking to break up old road (for whatever purpose) and the taxpayer reclaiming that broken up road. And if the taxpayer breaks up the road for the government, then a *service* is being performed by the taxpayer for the governmental entity. Thus the recycling operation is dissimilar, initially, from the integrated production steps of a quarry. Therefore the Kawasaki Wheel Loader and the CAT 980G Front End Loader are taxable, with, as the auditor put it, "The recycling operation" beginning "when materials are loaded into the plant and ends at the point that the production has altered the item to its completed form."

## FINDING

The taxpayer is denied regarding its protest of the Kawasaki Wheel Loader and the CAT 980G Front End Loader.

## II. Sales/Use Tax: Rough Terrain Crane

## DISCUSSION

The taxpayer describes the "rough terrain crane" thusly: "The proposed assessment appears to be taxing this crane as a repair part or tool. The crane is neither a repair part or tool—it is a necessary piece of equipment used to access the processing plant for making adjustments to production equipment and facilities. This crane is in constant use and should be considered processing equipment." And in another piece of correspondence, "The Crane … was not used for constructing the plant which was already in operation. The crane was used for plant screen changes, plant repair, mobile equipment engine removals and replacements, etc."

45 IAC 2.2-5-8(h)(1) states in part:

> Machinery, tools, and equipment used in the normal repair and maintenance of machinery used in the production process which are predominantly used to maintain production machinery are subject to tax.

(45 IAC 2.2-5-9(h)(1) and 45 IAC 2.2-5-10(h)(1) also have similar language).

The use of a crane for "screen changes" and "plant repair" comes within the ambit of 45 IAC 2.2-5-8(h)(1).

## FINDING

The taxpayer is denied regarding its protest of the rough terrain crane.

## III. Sales/Use Tax: Calcium Chloride

## DISCUSSION

The auditor noted that the taxpayer applied calcium chloride "to road surfaces in plant locations and mines to reduce the airborne dust. The purpose includes the need to comply with standards of government environmental agencies."

The taxpayer states:

> The calcium chloride was used in the operation of a facility, namely the quarry. The road beds had to be sprayed with the chloride to meet the government environmental requirements.

And further stated "[t]he calcium required to maintain dust control on the road beds is clearly an essential material consumed in the integrated production process."

Indiana Code 6-2.5-5-30 provides an exemption for environmental quality compliance, which states in part:

> Sales of tangible personal property are exempt from the state gross retail tax if:
> (1) the property constitutes, is incorporated into, or is consumed in the operation of, a device, facility, or structure predominantly used and acquired for the purpose of complying with any state, local, or federal environmental quality statutes, regulations, or standards; and
> (2) the person acquiring the property is engaged in the business of manufacturing, processing, refining, mining, or agriculture.

The Auditor stated that the "calcium chloride is not subject to this exemption because the chemical is not *consumed* in the operation of a device, but continues on the ground to control dust and is dissipated over a period of time after the chemical has been released." (*Emphasis added*).

45 IAC 2.2-5-70(b) states in part that "Consumed," means "the dissipation or expenditure by combustion, use or application…." Thus, from what the Auditor stated, the calcium chloride "dissipates over a period of time" and is not dissipated in the "combustion, use or application."

The calcium chloride does not meet the requirements of the IC 6-2.5-5-30(1) and 45 IAC 2.2-5-70(b).

## FINDING

The taxpayer is denied with regards to the calcium chloride.

## IV. Sales/Use Tax: Computer Equipment and Various Other Items

## DISCUSSION

The taxpayer also challenges the auditor's assessment of computer equipment:

> The Agent assessed tax on all computer equipment purchased for use in Indiana. There was no attempt to determine the ultimate use of those computers, many of which are used to operate the crushers, conveyor lines, washers and radial stackers.

The auditor taxed the computer equipment per 45 IAC 2.2-3-4. Under 45 IAC 2.2-5-8, computer equipment can be exempt, but it is a fact-sensitive analysis. Taxpayer has failed to meet the burden of proof (*See* IC 6-8.1-5-1(b)) of demonstrating that the computer equipment is exempt under 45 IAC 2.2-5-8.

The taxpayer argues that the auditor "negotiated various percentages of taxable portions of loaders, supplies used in production, and certain other purchases with plant and quarry personnel after informing them of his interpretation of the administrative rules.…" and "[t]hus, he had a direct influence on the plant personnel's determination of the exempt or taxable portion of the expense items." Taxpayer offers no basis for the numbers and percentages that it offered up to replace those "negotiated" percentages. Additionally, the taxpayer disagreed with the sampling method. The file contains projection methods that were signed and agreed to by the taxpayer at the time of the audit. The taxpayer, at hearing, listed various items that it either agreed or disagreed with the auditor on. The taxpayer then offered proposed taxable percentages for some of the items, but as with the computer equipment, the taxpayer has failed to develop its argument and meet its burden of proof.

## FINDING

The taxpayer's protest is denied regarding the computer equipment. The taxpayer is also denied regarding the various items for which the taxpayer offered "new" taxable percentages, and is denied regarding its protest of the sampling method.

## V. Sales/Use Tax: Public Transportation

## DISCUSSION

Indiana Code 6-2.5-5-27 states that:

> Transactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property.

An Indiana Tax Court case has also recently dealt with IC 6-2.5-5-27. In Carnahan Grain, Inc. v. Ind. Dept. of State Revenue, 2005 Ind. Tax LEXIS 29 (Ind. Tax Ct. 2005), the Indiana Tax Court explained that the Tax Court's prior public transportation case—Panhandle Eastern Pipeline Co. v. Indiana Dept. of State Revenue, 741 N.E.2d 816 (Ind. Tax Ct. 2001)—"rested entirely on Panhandle's use of the property." Carnahan at *8. The Indiana Tax Court went to hold in Carnahan that "because Carnahan predominantly used the property at issue for transporting agricultural commodities owned by third parties, it is entitled to the public transportation exemption." Carnahan at *11.

Turning to the argument, the auditor states that the taxpayer bought a trucking company "and began using the trucks primarily to haul aggregates that it sold to customers." The auditor noted:

> The taxpayer does not qualify for the exemption allowed for property used in public transportation of property because the taxpayer is predominantly transporting property that is owned by the taxpayer until delivery to the customer has been completed.

Taxpayer likewise notes that it "acquired a small fleet of trucks … and since that time has been using these vehicles to transport aggregates products to customers." The taxpayer states:

> It is the business', as well as industry, practice to quote the sales price of aggregate products to customers with shipping terms "F.O.B. our Plant." With these terms, the decision of how to transport the product rests with the customer. Generally speaking, it is the customer's option of how product is delivered to his premises—he can arrange his own transportation, using either his own fleet or by hiring a third-party common carrier or by having [Taxpayer] perform these services.
> The business' practice since its acquisition of the [Trucking company] assets … has been to charge sales tax to customers on the sales price of the aggregates product at the point of sale (plant). [Taxpayer] added transportation charges when these services were provided and separately stated these fees on the invoice from the sales price of the product.

And finally,

> …the typical shipping terms that are customary to the taxpayer and this industry are "F.O.B. origin". Therefore, the title to the goods and risk of the loss pass to the customer while the goods are at the premises of the seller.

The taxpayer relies on Department of Revenue v. Calcar Quarries, Inc. to buttress its argument. In Calcar the Court of Appeals noted:

> The State contends that Calcar was not engaged in public transportation but instead was engaged primarily in the service of hauling its own product.

Calcar Quarries, Inc., 394 N.E.2d 939, 941. Calcar, it should be noted, "sold its products F.O.B. Calcar's plant." Id. at 941. The Court of Appeals stated that "[t]he evidence proves that Calcar, … transported property for consideration by highway and satisfied the State's definition of 'public transportation.'" Id. at 941.

The Auditor quotes IC 26-1-2-401: "Unless otherwise *explicitly* agreed, title passes to the buyer at the time and place at which the seller completes his performance with reference to the physical delivery of the goods, …." (*Emphasis added*) However, "F.O.B. Our Plant," amounts to an *explicit* term.

Finally, the taxpayer provided a letter and documents with "two asset listings, one in which the truck division hauled primarily [taxpayer's] sales and the other one in which 80% was public transportation."

## FINDING

Taxpayer's protest is sustained.

## VI. Tax Administration: Penalty and Interest

## DISCUSSION

The taxpayer protests the imposition of the ten percent (10%) negligence penalty. The Indiana Code section 6-8.1-10-2.1 imposes a penalty if the tax deficiency was due to the negligence of the taxpayer. Department regulation 45 IAC 15-11-2(b) states that negligence is "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer."

Subsection (d) of IC 6-8.1-10-2.1 allows the penalty to be waived upon a showing that the failure to pay the deficiency "was due to reasonable cause and not due to willful neglect…." To establish this the "taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed . . . ." 45 IAC 15-11-2(c).

Taxpayer argues that the penalty should be abated. The taxpayer notes that it has "practiced a best effort policy and tried to be a compliant taxpayer…." The taxpayer also states that it "paid use tax every quarter…."

Given the fact-sensitive analysis required in reaching the various findings herein, and the taxpayer's efforts to be compliant, the taxpayer is sustained regarding the penalty. Regarding

interest, IC 6-8.1-10-1(e) states the Department "may not waive the interest imposed under this section."

## FINDING

The taxpayer is sustained regarding the penalty; the taxpayer is denied regarding interest.

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